

Using a Financial Model for Long-Term Debt Financing

Kutno and Namyslow, Poland

Background

Despite the creditworthiness of many Polish municipalities and a growing domestic capital market, opportunities for municipal long-term debt financing of infrastructure investment are under-utilized. The lack of practical tools and training is the most critical constraint in developing the municipal credit and municipal bond markets in Poland. A standardized computer model can help local governments analyze their debt-carrying capacity and help banks and underwriters appraise loan applications and municipal bond issues.

Innovation

In early 1995, The Municipal Development Agency (MDA), an independent Polish institution working to expand the capital market for municipalities and increase municipal investment, developed a computer model for local government financial analysis. The model provides a simple, computer-based methodology for making medium-term projections of municipal budget revenues and expenditures and the resulting funds available for investment and debt service. Using the model, municipalities can realistically schedule capital investment plans using various debt-financing scenarios. In pilot applications the analysis has proven useful in assisting municipalities to understand their debt carrying capacity, presenting the data in a clear and understandable format and providing the basic data needed for loan applications and information memoranda for municipal bonds. The initial model was developed and tested in the Cities of Namyslow (population 26,600) and Kutno (population 113,000) in July–November 1995 and has since been used by the cities of Ostrow Wielkopolski, Grudiaz, Gliwice, and Warsaw. The model is written in Microsoft® Excel 5.0 for Windows. Implementation requires assessment of historic revenue and expenditure data and assumptions and the capital investment plan; refining of the initial analysis of available funds and capital project scheduling, and presentation of the final analysis and recommendations to the Executive Board or City Council. Once this initial work is complete, city staff will need follow-up training in using the model as well as assistance in preparing loan applications or information memoranda for bonds.

Results

There have been four full pilot applications of the model, with positive results that prove its usefulness. In June 1996, the City of Kutno obtained the first substantial post–World War II long-term municipal infrastructure loan from commercial bank funds. The City of Ostrow Wielkopolski successfully completed a municipal bond issue. One municipality was recommended not to incur additional debt based on the results of the model, and the City of Namyslow received a subsidized loan from a national environmental fund. The impact of these pilots and the associated training of municipalities, banks and institutions have contributed to wide acceptance of the methodology and model. The model has been adopted by the MDA, five commercial banks with municipal lending departments, all of the municipalities in which it has been used, the National Bank of Poland department responsible for municipal lending supervision, and the Polish Securities Commission. In addition, a growing number of cities are interested in adopting the model and are requesting training in its application. The basic methodology and model logic can easily be applied in CEE and NIS countries, with some adjustments for official budget categories of concerned municipalities. The MDA can provide the spreadsheet program to interested cities, but operating manuals are still being completed, and first-time users will need assistance in implementing the model.

Summary

To help local governments analyze their debt-carrying capacity and help banks and underwriters appraise loan applications and municipal bond issues, the Municipal Development Agency developed a computerized financial analysis model and implemented it in the Cities of Namyslow and Kutno. With the assistance of the model's analysis, the City of Kutno obtained a long-term municipal infrastructure loan from a commercial bank, and the City of Namyslow successfully applied for a subsidized loan from the national environmental fund.

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